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HIGHLIGHTS

This issue contains detailed descriptions of:

- [Developments in Assistance to Financial Markets](#), including:
 - [The Treasury's New Financial Stability Plan](#)
 - [Continued Assistance to Firms Through the TARP](#)
 - [Proposed Resolution Authority for the Treasury for Nonbank Financial Firms](#)
 - [Actions by the Federal Reserve and FDIC](#)
- [Mortgage Loan Modification Efforts](#), including:
 - [The Treasury's Making Home Affordable Program](#)
 - [Proposed Helping Families Save Their Homes Act of 2009](#)
- [Actions Against Tax Havens](#)

In addition, it summarizes [other notable legislative, regulatory, and judicial developments that occurred during the first quarter of 2009](#).

DEVELOPMENTS IN ASSISTANCE TO FINANCIAL MARKETS

This quarter saw a number of legislative and regulatory actions designed to respond to the ongoing recession. The federal government enacted a number of new spending programs in an effort to restore economic growth, and agencies continued to work to stabilize turbulence in the financial world.

Treasury Releases Financial Stability Plan

On February 10, Secretary of the Treasury Timothy Geithner outlined the new administration's [Financial Stability Plan](#). So far, the Treasury has announced a Public-Private Investment Program to purchase troubled assets from financial institutions, a Capital Assistance Program to bolster capital buffers at large banks,

and a series of actions intended to free up credit for small businesses. These programs are designed to increase lending to consumers and businesses and to increase confidence in the financial system.

Public-Private Investment Program

On March 23, the Department of the Treasury announced a [new Public-Private Investment Program](#) (PPIP) to purchase troubled real estate-related assets from financial institutions. The PPIP will purchase \$500 billion to \$1 trillion in assets using a combination of \$75 billion to \$100 billion in Troubled Asset Relief Program (TARP) funds, private capital, debt financing from the Federal Reserve's new Term Asset-Backed Securities Loan Facility (TALF), and debt guarantees from the Federal Deposit Insurance Corporation (FDIC).

Troubled “legacy assets” are the target of these programs. “Legacy loans” are commercial or residential real estate loans held directly on the books of banks, and “legacy securities” are securities backed by loan portfolios.¹ Falling housing prices and deteriorating economic conditions led to losses from these assets, prompting rapid deleveraging by financial firms to reduce their exposure. The resulting fire sales drove down the prices of legacy securities, causing the net worth of financial firms to decline and beginning a vicious cycle of declining asset prices that has strained the balance sheets of financial institutions. Though the PPIP will initially target real estate-related assets, the Treasury may expand its scope as need arises.

Legacy Loans Program

The Legacy Loans Program will use FDIC debt guarantees and Treasury equity co-investment to attract private capital to purchase eligible loan assets from banks. The program will particularly encourage the participation of mutual funds, pension plans, insurance companies, and other long-term investors.

The FDIC will oversee the formation, funding, and operation of a number of public-private investment funds (PPIFs) that will purchase bad assets from banks. The Treasury and private investors will invest equal amounts of equity capital into the PPIFs, and the FDIC will provide a guarantee for debt financing by the PPIFs up to a maximum debt-to-equity ratio of six to one. The FDIC’s guarantee will be collateralized by the purchased assets, and the FDIC will receive a fee. The Treasury will manage its investment on behalf of taxpayers, but private investors will retain control of asset management, subject to FDIC oversight.

Banks will submit to the FDIC assets they wish to sell, typically pools of loans. The FDIC will

review and assess the riskiness of the pool and, based on this risk, will determine the exact level of PPIF-issued debt it will guarantee. The FDIC will then auction the pool to private investors. The winning bid will be offered to the selling bank, which may decide to reject the bid and retain the loans.

For example, a bank may wish to sell a pool of loans with a face value of \$100. The FDIC then evaluates the pool of loans, determines it sufficiently safe to leverage at the maximum six to one debt-to-equity ratio, and puts it up for auction. Say the highest bid from private investors is \$84. To actually fund the purchase, the Treasury and the winning bidders would form a new PPIF by each contributing \$6 of equity, and the PPIF would issue FDIC-guaranteed debt for the remaining \$72.

In this way, investors will reenter the market for these loans, and the auction system will determine the fair market price. Private investors with an incentive to maximize value will manage the servicing of their asset pools; banks’ balance sheets will be cleansed of the troubled assets, allowing them to resume normal functioning.

Legacy Securities Program

The Legacy Securities Program will draw private capital into the market for troubled securities by providing matching equity capital from the Treasury under the PPIP and debt financing from the Treasury and the Federal Reserve through the TALF.

Under this program, private investment managers will have the opportunity to apply for a position as fund manager (FM) of a new PPIF. The Treasury expects to accept five applications but may add more at its discretion. Acceptance will be based on the applicant’s track record in the targeted asset classes, a minimum amount of assets currently under management by the applicant in the targeted asset classes, and detailed structural proposals for the PPIF.

¹ In the past, these assets and securities have been referred to as “troubled” or “toxic.”

Approved FMs will have a period of time to raise private capital to purchase legacy securities and will receive matching equity capital from the Treasury. If an FM meets certain guidelines, as yet unspecified, it will also have the ability to subscribe to the Treasury for senior debt for the PPIF worth 50 percent of the fund's total equity capital. This amount may be increased to 100 percent if requested by the FM and approved by the Treasury.

For example, suppose an approved FM is able to raise \$100 in private capital for its PPIF. The Treasury would then match the \$100 through an equity co-investment. The Treasury would also provide a \$100 loan to the PPIF, which could be increased to \$200 if requested by the FM and approved by the Treasury. The FM of the PPIF would then use this \$300 to \$400 to purchase targeted legacy securities.

The Treasury expects the PPIFs to initially target both residential and commercial nonagency mortgage-backed securities (MBS) originated prior to 2009 with a rating of AAA at origination. FMs will have full discretion in investment decisions, although the PPIFs will generally follow a long-term buy-and-hold strategy.

Applications for FMs were originally due on April 10, but an April 6 [announcement](#) extended the deadline to April 24. The announcement also clarified the Treasury's position that no single factor would automatically exclude an applicant from becoming an FM; applications will be viewed holistically. The Treasury is also encouraging small, veteran, minority- and women-owned businesses to partner with private asset managers to take advantage of the program.

In addition to this program, the Federal Reserve intends to expand eligible collateral for its nonrecourse TALF loans to include legacy securitization assets as a way to further jump start the market. Eligible assets are expected to include certain nonagency residential MBS that were

originally rated AAA, and outstanding and commercial MBS and ABS that are rated AAA.

Capital Assistance Program

On February 25, the Treasury released terms and conditions for its [new Capital Assistance Program \(CAP\)](#). The goal of the program is to increase confidence in the financial system by ensuring that banks have sufficient capital cushions against large future losses and to support lending to creditworthy borrowers.

Recent deterioration in the global and U.S. economic outlook has raised questions about financial institutions' ability to absorb potentially larger than expected future losses. Even though most institutions are considered solvent, general uncertainty about the economy has eroded confidence in the amount and quality of equity capital held by some. As a result, institutions have had difficulty raising capital and have cut lending to guard against downside risk.

The CAP will consist of two core elements. First, supervisors will require banks to perform forward-looking capital assessments to determine whether any of them need to establish additional capital buffers to absorb potential future losses and continue lending operations. The second element is access for qualifying institutions to contingent common equity provided by the Treasury.

The forward-looking assessment will involve evaluating expected losses if economic conditions turn out to be worse than forecasters are currently predicting. The parameters for the evaluation, also known as a "stress test," will be standardized and provided by regulators. Assessment will be mandatory for the 19 largest bank holding companies (BHCs) in the U.S. – those with \$100 billion or more in total assets; assessment will be optional for smaller banks.

Should a bank need to increase its capital following the assessment, it will have six months to raise it either through the market or through contingent common capital made available by the

Treasury under the CAP. A BHC may apply to the CAP immediately in order to ensure funding but may delay actually receiving this funding until the end of the six months in order to have time to raise as much private capital as possible. If a BHC receives capital from the Treasury under the CAP, it will be in the form of mandatory convertible preferred shares. With approval from its regulator, the BHC can later convert these shares into common equity at a conversion price set at a 10 percent discount from the BHC's prevailing stock price on February 9, 2009.

Unlocking Credit for Small Businesses

On March 16, the Treasury announced that it will initiate a five-point plan designed to ensure [access to credit for small businesses](#). Credit conditions have been particularly poor for these small businesses: New loans guaranteed by the Small Business Administration (SBA) are trending below \$10 billion this year, well under the approximately \$20 billion per year the SBA usually guarantees.

The Treasury intends to revitalize the secondary market for securitizations of SBA loans by purchasing \$15 billion of securities backed by loans from the SBA's 7(a) Loan and CDC/504 loan programs.² To increase new originations, the Treasury will increase the maximum dollar amount of 7(a) loans from 75 percent to 90 percent of the loan amounts. Also, the SBA will temporarily eliminate all up-front fees for 7(a) and CDC/504 loans and refund any fees charged since February 17, 2009.

The Treasury has called on all banks to increase lending to small businesses. To increase transparency and encourage such lending, all banks will be required to produce quarterly reports that summarize their small business lending, and

² The [7\(a\) loan program](#) provides guarantees to private lenders on small business loans up to a certain dollar amount. The [CDC/504 loan program](#) provides businesses with loans for major fixed assets such as land and buildings.

the 21 largest banks receiving government financial assistance will need to report this amount monthly.

Finally, the IRS will issue guidance giving tax breaks to small businesses, including carry-back provisions for losses, write-offs for plant and equipment investments, increased depreciation deductions, reduced estimated tax payments, and deductions for investors in small businesses. These provisions were mandated in the American Recovery and Reinvestment Act of 2009 ([Public Law No. 111-5](#)).

Continued Assistance to Firms Through TARP

The Treasury's \$700 billion Troubled Asset Relief Program (TARP) continued its operations this quarter.³ As described above, \$75 billion to \$100 billion from this program will be used to fund the PPIP. It has continued to offer emergency assistance to struggling financial institutions, including Bank of America, Citigroup, and American International Group (AIG), as well as many smaller banks.

More Capital, Loss Protection Guarantee for Bank of America

On January 15, the Treasury, the Federal Reserve, and the FDIC entered into an agreement with Bank of America (BoA) to provide a package of guarantees, liquidity access, and capital to support the stability of the large bank and the financial system as a whole. The Treasury will [invest \\$20 billion in TARP funds](#) in the company, receiving in exchange preferred stock with an 8 percent dividend.

The Treasury and FDIC will provide [protection against unusually large losses](#) on a \$118 billion pool of loans, commercial and residential MBS, and other assets, excluding unrealized marked-to-market losses. The majority of these assets were acquired when BoA purchased the nearly bankrupt investment bank Merrill Lynch in

³ For information about the creation of the TARP, see [Banking Legislation and Policy, Volume 27, Number 3](#).

September 2008. BoA will fully cover the first \$10 billion in losses, and the Treasury and the FDIC will cover 90 percent of any subsequent losses, up to \$10 billion.

The Federal Reserve will provide a nonrecourse loan facility to the company, which will terminate at the same time as the guarantee or at the request of BoA. The facility, which will become available if and when losses on the pool pass \$18 billion, will charge a fee on drawn funds of the overnight index swaps (OIS) rate plus 300 basis points, and an annual fee of 20 basis points on any undrawn funds.

In exchange for the guarantee, BoA will issue the government \$4 billion in preferred stock with an 8 percent dividend and warrants with an aggregate exercise value of 10 percent of the total amount of preferred stock issued. In addition, BoA is prohibited from paying dividends on common stock in excess of one cent per share per quarter for the next three years, and its executive compensation structure must meet government requirements.

Swapping Preferred for Common Equity in Citigroup

In an effort to strengthen its capital structure, on February 27 Citigroup asked its preferred shareholders, including the Treasury, to [swap some of their preferred shares for common equity](#). The swap would increase the company's tangible common equity to as much as \$81 billion if the exchange is fully subscribed, reducing dividend payments and raising the bank's tangible common equity to risk-weighted assets ratio to over 8 percent. The swap would not affect Citigroup's tier 1 capital ratio.

The Treasury agreed to the arrangement under certain conditions. Private preferred shareholders must agree to swap at least \$11.5 billion for the Treasury to participate. The Treasury will convert up to \$25 billion of the \$45 billion in preferred stock it received from TARP

investments and will receive the most favorable terms and price offered to any preferred shareholder. The remaining preferred stock will be converted into a trust preferred security that will also carry an 8 percent dividend. This exchange does not increase the Treasury's investment in Citigroup, but the exchange would increase its ownership stake to about 36 percent.

Continued Assistance to AIG

On March 2, the Treasury and the Federal Reserve announced that they will restructure the terms of the government's assistance to American International Group Inc. (AIG), the world's largest insurance company. The agencies reasoned that, given the systemic risk AIG continues to pose, the potential cost to the economy of allowing the firm to fail could be extremely high. The government is continuing to extend aid so the company can meet its obligations as they come due while restructuring in an orderly manner.

To aid the struggling company, the Fed, in September 2008, created an \$85 billion revolving credit facility in exchange for a 79.9 percent equity interest. In November, the Treasury purchased \$40 billion in preferred stock from AIG using TARP funds; AIG used this money to repay the loans from the Fed. Once the loans were repaid, the Fed decreased the amount available through the facility to \$60 billion. At the same time, the Fed lowered the rates on its loans and created two new limited liability companies to purchase residential MBS and collateralized debt obligations (CDOs) from AIG, thereby removing the troubled assets from AIG's balance sheet. AIG drew down most of the funds available through these facilities in the subsequent months but continued to experience large losses and to face insolvency due to the weak economy and turbulent credit markets.

In [this new action](#), the Treasury will exchange its existing \$40 billion cumulative perpetual preferred shares for new noncumulative preferred stock. This stock will still carry an

annual dividend of 10 percent, but payment will be made at the discretion of AIG's board. If AIG fails to pay dividends for four quarters, which need not be consecutive, the Treasury will have the authority to replace 20 percent of the company's directors. In addition, AIG may redeem the preferred stock only with proceeds from the issuance of equity capital. The Treasury will also create a new \$30 billion facility from which AIG may draw in exchange for more of this noncumulative preferred stock.

The Fed also announced that it will take [several actions](#) related to its revolving credit facility for AIG. The total amount available under the facility will be reduced, but to no less than \$25 billion. The interest rate on the facility is the three-month LIBOR plus 300 basis points, with a floor on the LIBOR of 350 basis points; this formula will be modified by removing the floor and using the true LIBOR. AIG [estimates](#) that this will save about \$1 billion in interest costs per year, based on the current level of the LIBOR (around 100 basis points) and the current facility balance. AIG has drawn about \$38 billion so far.

In exchange for modifying the facility, the Fed will receive preferred interests in two special purpose vehicles (SPVs) that hold all of the outstanding common stock of the American Life Insurance Company (ALICO) and American International Assurance Company (AIA), two life insurance holding company subsidiaries of AIG. AIG will retain control of the companies, but the New York Fed will have certain governance rights. The Fed will receive preferred stock interests in the SPVs worth a percentage of ALICO's and AIA's fair market valuations; the value of the interests may total up to \$26 billion.

In addition, the Federal Reserve Bank of New York will be authorized to make new loans of up to approximately \$8.5 billion to SPVs established by domestic life insurance subsidiaries of AIG, which will be repaid from the net cash flows of the existing life insurance policies held by

the parent insurance companies. Proceeds from these loans will pay down an equivalent amount of outstanding debt from the revolving credit facility. The exact amounts to be lent and the terms of the loans have not yet been determined.

Resolution Authority for Systemically Significant Financial Companies Proposed

On March 23, the Treasury proposed [new legislation](#) that would give it resolution authority over systemically significant financial institutions that fall outside the existing resolution authority of the FDIC. The proposal would fill in several gaps in the current regulatory structure and allow the Treasury to more actively manage systemic risk.

Currently, when a large nonbank financial firm is in distress, it has two options. It can file for bankruptcy, potentially leading to systemic effects (e.g., Lehman Brothers), or it can request assistance from the U.S. government, putting taxpayer funds at risk (e.g., AIG). Under the proposed legislation, the Treasury would have the authority to put troubled nonbank financial firms into conservatorship or receivership⁴ and then administer an orderly reorganization or wind-down. This ability would limit the need for ad hoc taxpayer bailouts and allow the government to act to minimize the systemic impact.

The Treasury's authority would apply to financial institutions that pose a systemic risk but are not currently subject to the resolution authority of the FDIC. This would include bank and thrift holding companies, as well as any holding companies that control broker-dealers, insurance companies, or futures commission merchants. The Treasury would be able to take action only if it determined that a firm was in danger of becoming insolvent, that this insolvency would pose systemic

⁴ The objective of a conservatorship is to take action to restore the firm to solvency through reorganization so it can carry on its business. The objective of a receivership is to liquidate the firm in an orderly manner.

risk, and that action by the Treasury could mitigate these adverse effects.

If intervention was deemed necessary, the Treasury, in consultation with the Federal Reserve and the FDIC, would determine whether the firm should be put into conservatorship or receivership. The regulators could also offer the firm financial assistance by making loans, purchasing its assets, guaranteeing its liabilities, or purchasing an equity interest in it. The Treasury conservatorship or receivership would operate in much the same way as an FDIC action at a depository institution. The goal would be to minimize the systemic impact of the firm's failure on both consumers and the financial system as a whole, rather than simply addressing the rights of its creditors, as in bankruptcy. The Treasury would have broad powers to liquidate the firm's assets, renegotiate its contracts (including with its employees), and fundamentally restructure the institution. None of these actions would require approval from the firm's creditors or stakeholders.

Funding for the resolution authority could come from the creation of a fund, similar to the FDIC's Deposit Insurance Fund, formed by assessing a fee to each covered institution. This assessment could be made ex ante or ex post and could be augmented by an appropriation from the Treasury. The government could be repaid for its resolution actions from the redemption of any loans made or the sale of any equity interests taken by the government.

Federal Reserve Actions

TALF Launched

On March 3, the Fed launched its new [Term Asset-Backed Securities Loan Facility](#) (TALF), which is designed to increase credit availability by facilitating issuance of consumer asset-backed securities (ABS). Since announcing the program in November 2008, the Fed has made changes to the TALF's terms to broaden accepted collateral and increase its lending limit.

The TALF is designed to provide financing to investors to support their purchases of certain ABS, helping to bring investors back to the markets for these securities. The TALF will make nonrecourse loans to investors who pledge their ABS as collateral. Originally, eligible collateral for TALF loans included AAA-rated ABS backed by new and recently originated auto loans, credit card loans, student loans, and SBA-guaranteed small business loans.

On February 10, the Fed and the Treasury announced an [expansion of the TALF](#) to include new asset categories. The TALF, in supporting the Treasury's [Making Home Affordable](#) programs, will eventually also accept commercial MBS and nonagency residential MBS. The TALF's total lending limit will also increase from its original \$200 billion to as much as \$1 trillion.

As part of its March 3 launch, the Fed revised the terms of the TALF to decrease the interest rates and collateral "haircuts" charged on loans secured by ABS guaranteed by the SBA or backed by government-guaranteed student loans.

The first round of applications for TALF loans was due on March 19, but only the originally accepted asset classes could be pledged as collateral. The initial subscriptions totaled \$4.7 billion. A second round on April 7 generated \$1.7 billion in further lending.

The TALF will terminate on December 31, 2009, unless it is extended.

Rules for AMLF, Tri-Party Repos Relaxed

On January 30, the Federal Reserve announced two final rules related to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), which extends loans to banks to finance their purchases of high-quality asset-backed commercial paper from money market mutual funds.

The first rule [amends Regulations H and Y](#) to provide temporary exemptions from the Fed's leverage and risk-based capital requirements for

bank holding companies and state member banks. The rule allows them to apply a 0 percent risk weight to assets purchased through AMLF participation and to exclude these assets from average total consolidated assets when calculating leverage ratios.

The second rule [amends Regulation W](#) to provide a temporary limited exception from sections 23A and 23B of the Federal Reserve Act; the substantial protections provided to intermediaries by the AMLF mitigate the safety and soundness concerns that 23A and 23B address.

The Fed believes that these two rules will facilitate participation by depository institutions and bank holding companies as intermediaries between the AMLF and money market mutual funds.

The Fed also issued a final rule that [amends Regulation W](#) to provide a temporary exception to certain section 23A limitations, allowing all insured depository institutions to provide liquidity to their affiliates for assets typically funded in the tri-party repo market. The exemption is valid for asset types that the affiliate financed in the tri-party repo market during the week of September 8-12, 2008, and is subject to certain conditions to promote safety and soundness. This exemption will expire on October 30, 2009.

Liquidity Facilities Extended for Six Months

On February 3, the Federal Reserve [extended its existing liquidity programs](#) through October 30, 2009. The AMLF, the Commercial Paper Funding Facility (CPFF), the Money Market Investor Funding Facility (MMIFF), the Primary Dealer Credit Facility (PDCF), and the Term Securities Lending Facility (TSLF) had been scheduled to expire on April 30.

In addition, the temporary reciprocal currency agreements (swap lines) between the Fed and other central banks were also extended through October 30. The first of these swap lines opened in October 2008 to improve liquidity in

short-term U.S. dollar funding markets. On April 6, the Fed authorized [new reciprocal currency arrangements](#) with the Bank of England, European Central Bank, Bank of Japan, and Swiss National Bank to address the potential foreign currency needs of U.S. institutions. The arrangements would support operations by the Fed to provide liquidity in pounds sterling, euros, yen, and Swiss francs if the need should arise.

Final Rule Delays New Tier 1 Capital Restrictions for Bank Holding Companies

On March 17, the Federal Reserve adopted a [final rule](#) that delays the implementation of an amendment to Regulation Y until March 31, 2011. The amendment, originally approved in 2005 and scheduled to take effect on March 31, 2009 ([70, Federal Register, pp. 11827-38](#)), would have restricted the ability of a bank holding company (BHC) to include certain restricted core capital elements in its calculation of tier 1 capital. Delaying the implementation of the rule allows BHCs to continue to include in their tier 1 capital cumulative perpetual stock and trust preferred securities up to 25 percent of the sum of core capital elements, which will help them to maintain healthy regulatory capital ratios.

FDIC Initiatives

Efforts to Ease Stress on Deposit Insurance Fund

Over the past several months, the FDIC has acted as receiver for dozens of banks that were closed by their regulators. This, in turn, has placed extreme stress on its Deposit Insurance Fund (DIF), from which it covers the costs of compensating insured depositors. At the end of 2008, the balance of the DIF stood at \$19 billion. This represents a reserve ratio of just 0.4 percent, well below the legislatively mandated level of 1.15 percent.

To replenish the DIF, the FDIC issued a rule in December that increases assessments on banks.⁵

⁵ For details on the DIF restoration plan, see [Banking Legislation and Policy, Volume 27, Number 4](#).

However, more banks than expected have failed this quarter, and the outlook for the financial sector continues to look grim. As a result, on February 27 the FDIC issued rules to amend the restoration plan ([74, Federal Register, p. 9564](#), [74, Federal Register, pp. 9525-63](#)). The amended plan would lengthen the horizon for complete replenishment of the DIF from five years to seven years. Beginning on April 1, 2009, the top assessment rate on banks in the best risk category would increase from 14 basis points to 16 basis points per dollar of deposits.

Assessments would also increase further on institutions that rely heavily on brokered deposits to fund rapid asset growth or rely significantly on secured liabilities. The FDIC argues that the primary purpose of the secured liability adjustment is to remedy an inequity. An institution with secured liabilities in place of another's deposits pays a smaller deposit insurance assessment, even if both pose the same risk of failure and would cause the same losses to the FDIC in the event of failure.

Assessments would decrease for institutions that hold long-term unsecured debt, as well as for small institutions with high levels of tier 1 capital.

In addition, the FDIC [released an interim rule](#) that would charge a 20-basis-point special assessment on all member institutions on June 30, 2009, to be collected on September 30, 2009. Under this rule, the FDIC would also be permitted to charge another emergency special assessment of up to 10 basis points after June 30, 2009, if necessary.

To further protect the DIF, the FDIC has requested that Congress increase its line of credit with the Treasury from \$30 billion to \$100 billion. This credit has never been used, but having it available would decrease the likelihood that the DIF would become insolvent. A provision of the proposed Helping Families Save Their Homes Act of 2009 ([H.R. 1106](#)) would enact this request and allow the Treasury under certain conditions to temporarily increase the line of credit to up to \$500 billion.

In addition, the bill would extend the \$250,000 limit on bank deposit insurance through 2015. The FDIC temporarily raised the limit to this amount from \$100,000 beginning in October 2008, but it will reset at the end of 2009 if Congress does not extend it.

The bill would also increase the line of credit available to the National Credit Union Administration from \$100 million to \$6 billion to ensure the solvency of its National Credit Union Share Insurance Fund (NCUSIF), which is analogous to the DIF for credit unions.

TLGP Extended Through October

On March 17, the Board of the FDIC announced an interim rule to [extend its Temporary Liquidity Guarantee Program](#) (TLGP) through October 31, 2009. The TLGP was originally enacted in November 2008 to guarantee newly issued unsecured debt from banks and thrifts and to provide full coverage of non-interest-bearing transaction deposit accounts.⁶

Originally, the TLGP covered debt issued by June 30, 2009, for up to three years. This interim rule would allow the program to cover debt issued by October 31, 2009. For debt issued on or after April 1, the guarantee will last through December 31, 2012.

The TLGP will impose a surcharge on all guaranteed debt issued on or after April 1, 2009. Guaranteed debt that is issued by June 30, 2009 and matures by June 30, 2012 will be charged 10 basis points annually for insured depository institutions and 20 basis points annually for all other institutions, such as bank holding companies. All other guaranteed debt issued on or after April 1 will be charged 25 basis points for depository institutions and 50 basis points for other institutions. This surcharge comes in addition to current fees and will be deposited into the DIF to limit the need for special assessments.

⁶ For more information on the TLGP, see [Banking Legislation and Policy, Volume 27, Number 4](#).

MORTGAGE LOAN MODIFICATION EFFORTS

The current recession began with trouble in the housing market characterized by falling prices and increasing foreclosure rates, particularly among subprime mortgages. This quarter, legislators and regulators have proposed measures aimed at alleviating the downturn in the housing market by aiding homeowners through financial assistance and modification of their loans. In addition, the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac have received additional aid so they can continue to perform their role in the secondary mortgage markets.

Making Home Affordable Program

On March 4, the Treasury released details for its [Making Home Affordable](#) program, which will offer assistance to an estimated 7 to 9 million homeowners. The initiative includes a refinancing program for homeowners losing equity because of falling home prices and a \$75 billion mortgage modification program, and it continues the Treasury's efforts to assist the struggling GSEs Fannie Mae and Freddie Mac.

Home Affordable Refinance Program

The Home Affordable Refinance Program provides low-cost refinancing to borrowers who are otherwise unable to refinance because of insufficient home equity. Thanks to aggressive action by the Treasury and the Federal Reserve, interest rates for mortgages are near all-time lows. However, borrowers who owe 80 percent or more of the value of their homes are usually ineligible for refinancing and unable to take advantage of these low rates. This problem has become more prevalent as home prices have dropped over the last two years.

A homeowner who is current on the mortgage for a principal residence owned or securitized by Fannie Mae or Freddie Mac is eligible for refinancing under the program. Eligibility is contingent on the homeowner's ability

to demonstrate sufficient income to support the new mortgage payments.

The amount of the refinanced loan may not exceed 105 percent of the current market value of the home; cash-out refinancing is not available. The interest rate on the new loan will be based on market rates but will vary among lenders.

The program expires on June 10, 2010. The Treasury estimates that as many as 4 to 5 million homeowners are eligible for this program.

Home Affordable Modification Program

For borrowers in more immediate danger of losing their homes, the Treasury is instituting a \$75 billion Home Affordable Modification program, along with other targeted regulations and programs to prevent foreclosures.

Loan Modification Plan

The modification program is designed to reduce monthly mortgage payments for homeowners with a high risk of foreclosure, such as those who have had severe income disruptions, have resetting adjustable rate mortgages, or whose mortgages are "under water" – i.e., the mortgage balance is larger than the current market value of the home. Borrowers who are delinquent on their loans but are not yet in foreclosure are eligible for the program. Also eligible are borrowers who are not yet delinquent but are at imminent risk of delinquency.⁷

The homes must be owner-occupied primary residences. The loans must have been

⁷ Imminent risk of delinquency may arise because of a change in the homeowner's circumstances that leads to financial hardship or because the homeowner is facing a recent or imminent increase in the mortgage payment that is likely to cause a hardship. If a borrower seeks a modification because of an imminent risk of default or delinquency, it is the servicer's responsibility to verify current income and expenses and apply a net present value (NPV) test to determine the expected repayment with and without modification. If the NPV is greater with modification, the modification must be offered. The parameters for this test are available in the [Modification Program Guidelines](#).

originated on or before January 1, 2009, and have an outstanding principal balance no greater than the current Federal Housing Finance Agency (FHFA) conforming loan limit of \$729,750 (for one-unit residences). Homeowners with total “back-end” debt payments – which include housing loans, auto loans, credit card debt, and other obligations – that total at least 55 percent of their monthly gross income will have to enter HUD-certified debt counseling to be eligible.

The program works with servicers and investors to reduce monthly mortgage payments for qualified borrowers to a 31 percent debt-to-income (DTI) ratio. A modification will be planned by the servicer and will primarily rely on reducing the interest rate to as low as 2 percent. If this does not reach the desired 31 percent DTI, the servicer may then extend the term of the loan to as long as 40 years and finally may forbear principal at no interest.⁸ To assist the process and limit lender losses, the government will match, dollar for dollar, the reduction in borrower payment from 38 percent DTI down to 31 percent DTI.

The modified payment will be maintained for five years to ensure continuing affordability. After this time, the interest rate can be increased 1 percent per year but will be capped at the conforming loan survey rate in place at the time of the modification. If the servicer forbears some principal, the borrower could still face a payment for that amount when the loan is repaid or refinanced or the home is sold.

Once the terms of the modification are final, the borrower will enter a three-month trial period at the new interest rate and payment level. If the borrower does not make all three payments, the modification will be revoked and the original terms of the mortgage reinstated.

The government will provide incentive payments to servicers and mortgage holders who

undertake successful and responsible modifications. Servicers will receive an upfront fee of \$1,000 for each eligible modification, plus an additional “pay for success” fee of \$1,000 per year for up to three years as long as the borrower remains in the program. In addition, if the modification is made before the borrower becomes delinquent, the servicer will be paid \$500 and the mortgage holder \$1,500. Servicers will receive similar incentives if they modify Federal Housing Administration (FHA), Veterans Administration (VA), or Department of Agriculture loans or if they refinance loans under FHA programs such as Hope for Homeowners (H4H).

To offer an incentive to avoid delinquency, the government will provide monthly payments to borrowers who stay current on their modified mortgages. This payment will be used to reduce principal on the loan and may total up to \$1,000 per year for five years. This borrower incentive is also available for modifying FHA, VA, or Department of Agriculture loans or for refinancing loans under H4H or similar programs.

There is a *de minimis* constraint on all of the above payments. To qualify, the modification must reduce the monthly mortgage payment by at least 6 percent.

To encourage modification of more mortgages, the Treasury, in conjunction with the Federal Deposit Insurance Corporation (FDIC), will provide a payment to mortgage holders to partially offset probable losses from failed modifications resulting from further declines in home prices. The Treasury will make cash payments to the mortgage holders on each modified loan as long as the loan stays in the program. This is designed to discourage lenders and investors from foreclosing on mortgages now for fear of home prices falling later. The payments, which could total up to \$10 billion, will be linked to changes in the home price index.

The program will also provide additional incentives to extinguish second liens on modified

⁸ Outright principal forgiveness or refinancing through a Federal Housing Administration program such as Hope for Homeowners is also acceptable.

mortgages. Servicers will receive compensation when they contact second lien-holders and extinguish valid junior liens. The compensation will be reimbursed according to a specified schedule based on the combined loan-to-value ratio, plus an additional \$250 for each extinguished junior lien.

Servicers have until December 31, 2009, to enter into the program agreements with the Treasury's financial agent. New borrowers will be accepted until December 31, 2012. Fannie Mae and Freddie Mac will be responsible, subject to the Treasury's oversight, for monitoring servicers' compliance with the program. The Treasury estimates that this program may reach as many as 3 to 4 million homeowners.

Clear and Consistent Guidelines for Loan Modifications

In issuing the [guidelines for the modification program](#), the Treasury seeks to create an industry standard for mortgage modifications that will bring order and consistency to foreclosure mitigation efforts. The guidelines build on programs implemented by the FDIC, the FHFA, and the FHA to prevent foreclosures.

Going forward, all financial institutions receiving assistance through the [Financial Stability Plan](#) will be required to implement loan modification plans consistent with these guidelines. Fannie Mae and Freddie Mac will apply these guidelines to all the loans they own or guarantee. Ginnie Mae, the FHA, the Treasury, the Federal Reserve, the FDIC, the Department of Veterans Affairs, and the Department of Agriculture have also agreed to apply these guidelines when permissible and appropriate.

The Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Reserve, the FDIC, and the National Credit Union Administration (NCUA) are expected to encourage the institutions they supervise to participate in the modification program and to adopt the Treasury guidelines.

The major mortgage insurance firms have agreed to develop a mechanism by which they will make partial claims on modified loans where appropriate.

Modifications of Home Mortgages During Bankruptcy

The administration will seek changes to bankruptcy provisions that will allow judicial modifications of mortgages for homeowners in bankruptcy. Legislation allowing these judicial "cram downs" could help homeowners with no other options develop responsible repayment plans.

Elements of the Helping Families Save Their Homes Act ([H.R. 1106](#)) would allow this judicial modification of mortgages in Chapter 13 bankruptcy proceedings. A judicial modification would be allowed only if borrower had tried unsuccessfully to obtain a loan modification from the servicer or if the judge determined that the modification offered by the servicer did not meet the guidelines of the loan modification program. The judge would be allowed to reduce the interest rate to the prime fixed rate at the time of modification, extend the repayment period up to 40 years, or, if necessary, write down the principal value of the home. The bill would also disallow charging excessive fees, penalties, or interest on mortgages while bankruptcy proceedings are ongoing. Any mortgages originated prior to the enactment of the law would be eligible for this treatment. This bill was passed by the House on March 5 and referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Strengthen Hope for Homeowners (H4H) Program

The administration has inserted provisions into [H.R. 1106](#) to make FHA's Hope for Homeowners (H4H) program a more attractive refinancing option. In its current form, the program requires that servicers write down the principal to 96.5 percent of its current market value, junior lien-holders relinquish their claims in

exchange for a small cash payment, and homeowners split any future profits from sale of the home with the government. So far only one H4H loan has been completed since the program was introduced last year.⁹

The proposed changes would decrease the FHA insurance premiums on the loans, offer servicers a \$1,000 payment for each successful H4H loan, and increase the allowable borrower debt level.

Continuing Assistance to GSEs

Fannie Mae and Freddie Mac, despite their ongoing financial problems, are still critical to the functioning of the U.S. housing market. The firms have been under FHFA conservatorship since September 7, 2008, when regulators declared them to be critically undercapitalized.¹⁰ The Treasury is undertaking several actions to ensure that the GSEs will continue their operations, providing liquidity to the housing market and keeping mortgage interest rates low.

First, the Treasury will increase its preferred stock purchase agreements with the GSEs from \$100 billion each to \$200 billion each. These agreements act as lines of credit for the GSEs, which can issue preferred stock to the Treasury in exchange for cash to ensure that they maintain a positive net worth. On February 25, following the release of its fourth-quarter financial statements, Fannie Mae [requested \\$15.2 billion](#) from the Treasury under the agreement to return to positive net worth. Fannie Mae reported quarterly losses of \$25.2 billion and total losses for 2008 of \$58.7 billion. On March 11, Freddie Mac [requested \\$30.8 billion](#) to cover its fourth-quarter losses and return to positive net worth. Freddie Mac's quarterly loss was \$23.9 billion, and its total losses for 2008 were \$50.1 billion.

⁹ According to FHA spokesman Brian Sullivan, as [quoted on CNN](#).

¹⁰ For information on the conservatorship, see [Banking Legislation and Policy, Volume 27, Number 3](#).

On January 28, the FHFA issued an interim rule that will allow the GSEs' portfolios to grow to \$850 billion each by the end of 2009. The rule outlines a timetable for the GSEs to then reduce their holdings by about 10 percent per year, down to \$250 billion each by 2020 ([74, Federal Register, pp. 5609-18](#)). This reduction in portfolio size is required by a provision of the Emergency Economic Stabilization Act (EESA) of 2008 ([Public Law No. 110-343](#)). In order to improve liquidity in the mortgage market in general, the Making Home Affordable Program will allow the GSEs to increase their portfolios to \$900 billion each.

The Treasury will also work with Fannie Mae and Freddie Mac to support state housing finance agencies and will continue its purchases of mortgage-backed securities (MBS) from the GSEs.

Federal Reserve to Increase Purchases of GSE Assets

On March 18, the Federal Reserve announced that it will [increase its purchases](#) of direct obligations of GSEs and GSE-backed MBS under a program initially announced on November 25, 2008.¹¹ The Fed will increase its purchases of direct debt obligations of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks from \$100 billion to \$200 billion. In addition, it will increase its purchases of MBS guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae by \$750 billion, to a total of \$1.25 trillion this year. Through these purchases, the Fed expects to boost liquidity in the MBS market and decrease the rate spreads on GSE debt, thus bringing down residential mortgage loan rates and allowing the GSEs to continue purchasing loans in the secondary market.

Proposed Legislation

Helping Families Save Their Homes Act of 2009

On February 23, Rep. John Conyers (D-Mich.) introduced in the House the Helping

¹¹ For more information on this program, see [Banking Legislation and Policy, Volume 27, Number 4](#).

Families Save Their Homes Act of 2009 ([H.R. 1106](#)). This bill contains numerous provisions to aid struggling homeowners, incorporating language from other proposed homeowner assistance legislation.¹²

As previously discussed, the legislation would modify the Hope for Homeowners program and allow judges to alter mortgage terms for homeowners in bankruptcy.

Other provisions would allow the Department of Veterans Affairs, the Department of Housing and Urban Development, and the Department of Agriculture to pay the holders of mortgages they had guaranteed the unpaid balances due as a result of modifications from foreclosure proceedings.

The bill also recommends that mortgage holders not initiate any foreclosure proceedings on owner-occupied principal dwellings until the provisions of the bill have been implemented and are operational.

The bill was passed by the House on March 5 and referred to the Senate Committee on Banking, Housing, and Urban Affairs.

ACTIONS AGAINST TAX HAVENS

In recent weeks, tax havens – nations or territories with a strong history of bank secrecy or lax regulation – have been the object of heightened international scrutiny. For years, foreigners have deposited assets in banks in these countries, often for the purpose of evading taxes at home.

However, with tax revenues dropping worldwide because of the broad economic downturn, several countries, led by the U.S., France, and Germany, have called for these tax havens to reform or face sanctions. As a result, many of the targeted territories have agreed to initiate reforms that will relax bank secrecy laws for cases of tax evasion.

¹² H.R. 1106 aggregates provisions from S. 61, H.R. 255, H.R. 200, and H.R. 786.

U.S. Agencies Target UBS

On February 18, the Swiss bank UBS AG agreed to pay \$780 million in fines, penalties, interest, and restitution to the U.S. government in a settlement of two criminal cases. UBS admitted that it had conspired to defraud the U.S. by impeding Internal Revenue Service (IRS) investigations ([United States v. UBS AG](#), S.D. Fla., No. 09-60033-CR-MARRA, indictment unsealed 2/18/09), and acted as an unregistered broker-dealer and investment adviser ([SEC v. UBS AG](#), D. D.C., No. 1:09-CV-00316, 2/18/09). As part of the deferred prosecution agreement, UBS also agreed to provide the U.S. government with the identities of, and account information for, certain U.S. customers of UBS's cross-border business, and to cease providing banking services to U.S. clients with undeclared accounts. If UBS complies with all of the obligations, the Department of Justice (DOJ) will dismiss with prejudice all charges against the company at the end of the 18-month deferral.

When UBS purchased the U.S. brokerage firm Paine Webber in 2000, it voluntarily entered into an agreement with the IRS that required it to report income and other identifying information for its U.S. clients who held U.S. securities in a UBS account and to withhold income taxes from U.S. clients who directed investment activities in foreign securities from the U.S. Between 2001 and 2008, UBS employees helped U.S. taxpayers open new UBS accounts under false names and sham entities, thus concealing their identities from the IRS and allowing UBS to evade its reporting and tax withholding obligations. From 1999 to 2008, UBS financial advisers also made thousands of trips to the U.S. to meet with clients, acting as broker-dealers without registering with the Securities and Exchange Commission (SEC) as required by law.

In the settlement, UBS agreed to pay \$400 million to the IRS in back withholding taxes. Another \$380 million in profits from UBS's cross-border business will also be disbursed, with \$180 million going to the DOJ and \$200 million to the

SEC. As a result of the agreement, on February 18, the DOJ, UBS, and the Swiss Financial Market Supervisory Authority (FINMA) [reached a deal](#) requiring UBS to disclose the names of nearly 300 of its U.S. clients.

On February 19, the IRS and DOJ asked the U.S. District Court for the Southern District of Florida to enforce nearly 52,000 [“John Doe” summonses](#) that were served on UBS in July 2008 for U.S. customers with secret UBS accounts ([U.S. v. UBS AG](#), S.D. Fla., No. 09-20423, petition filed 2/19/09). In the settlement UBS agreed to turn over the names of “certain” clients but reserved the right to contest the summonses in court. Under the U.S.-Swiss Double Taxation Agreement Treaty, Switzerland is required to provide judicial assistance in situations where the offense would constitute fiscal fraud under Swiss law. However, tax evasion is not a criminal offense in Switzerland. In addition, Swiss banking law prohibits John Doe subpoenas, and UBS could expose itself to criminal charges if it reveals the names of its clients. On February 20, a Swiss court issued a temporary injunction prohibiting FINMA from handing over UBS client information to any third party until these legal issues are resolved.

Stop Tax Haven Abuse Act Introduced in Senate

On March 2, Sen. Carl Levin (D-Mich.) reintroduced a bill ([S. 506](#)) in the Senate that would punish abusive use of overseas tax havens. The bill includes new disclosure rules, broadened authority for tax officials, and increased penalties to discourage offshore tax evasion.

The bill would amend the Internal Revenue Code to establish a legal presumption that any assets transferred by U.S. persons to or from accounts in designated tax havens represent unreported income that is taxable in the year of the transfer. Passive foreign investment corporations would be subject to increased tax reporting requirements for any U.S. persons who have done business with them. Offshore trusts would be

subject to increased oversight and taxes. The bill would also close a loophole that allows non-U.S. persons to avoid paying U.S. taxes on U.S. stock dividends.

The bill would place more stringent restrictions on companies chartered in tax haven nations that do business in the U.S. and augment the ability of the IRS to review and collect taxes from these companies and their business partners. In particular, the bill would treat any corporation that is publicly traded or has gross assets of \$50 million or more as a domestic corporation for income tax purposes if its day-to-day operations are based primarily in the U.S. Hedge funds and other unregistered investment companies would be required to establish anti-money laundering programs like those required for registered banks. Penalties on tax shelter promoters would be increased to 150 percent of their earnings.

The bill was referred to the Senate Committee on Finance. The 2007 version of this bill ([S. 681](#), 110th Congress) was never reported out of committee.

International Actions

Following the successful actions of the U.S. against UBS, several European Union member nations took steps to pursue their own tax evaders. On February 23, following a summit, France, Germany, Italy, Spain, and the United Kingdom reached an agreement that called for definitive action against tax havens. Representatives from France and Germany insisted that sanctions against tax havens also be included in any new global financial regulatory framework endorsed at the G-20 summit in April. On March 10 and 11, the French Assembly voted to increase penalties on French institutions and individuals that do business in the [uncooperative tax havens](#) as defined by the OECD.

With pressure increasing leading up to April’s G-20 summit, several targeted nations agreed to initiate reforms, such as relaxing bank

secrecy laws or negotiating new treaties related to tax evasion issues, in exchange for not being identified by the OECD as tax havens. Through March, Andorra, Austria, Belgium, Liechtenstein, Luxembourg, Monaco, San Marino, and Switzerland all agreed in principle to accept OECD tax standards.

Since the 1990s, the OECD has been developing a list of countries that it considers tax havens, issuing a report to the G-20 summit containing information on uncooperative countries

and territories. As part of an accord reached at the summit, the OECD published “black,” “gray,” and “white” [lists of tax havens](#). Four countries – Costa Rica, Malaysia, the Philippines, and Uruguay – made the black list. Thirty-six other countries and territories made the gray list, including those nations that agreed to initiate reforms but have not yet done so.

Within a week of the accord, all four blacklisted countries had agreed to initiate reforms and were moved to the gray list.

Federal Legislation

Enacted Legislation

Repeal of IRS Notice 2008-83

Section 1261 of the American Recovery and Reinvestment Act of 2009 ([Public Law No. 111-5](#)) repeals [Internal Revenue Service Notice 2008-83](#) going forward. The notice gave banks beneficial treatment of deductions for losses or bad debts following an ownership change under tax code Section 382(h). Tax treatment under the notice will be recognized only on contracts written on or before January 16, 2009.

Proposed Legislation

Credit Cardholders’ Bill of Rights Act Reintroduced

On January 22, Rep. Carolyn Maloney (D-N.Y.) reintroduced in the House a bill, the Credit Cardholders’ Bill of Rights Act of 2009 ([H.R. 627](#)), that would prohibit a number of misleading or predatory practices by credit card issuers. The bill was originally introduced in February 2008 ([H.R. 5244](#)) and approved by the House but failed in the Senate. (See [Banking Legislation and Policy, Volume 27, Number 1](#), for information on the bill’s provisions.) The reintroduced bill was referred to the House Committee on Financial Services. Companion legislation ([S. 235](#)) was introduced on January 14 by Sen. Charles Schumer (D-N.Y.) and referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Expansion of Criminal Code to Include Options and Futures on MBS

On March 5, Sen. Patrick Leahy (D-Vt.) introduced the Fraud Enforcement and Recovery Act of 2009 ([S. 386](#)) in the Senate. The bill would expand the general securities fraud statutes of the federal criminal code to include fraud involving options and futures on mortgage-backed securities (MBS). The bill would also redefine the term “financial institution” to include mortgage lending businesses, outlaw fraud related to the Troubled Asset Relief Program, and expand anti-money laundering statutes. The bill was referred to the Senate Judiciary Committee.

Creation of Federal Accounting Oversight Board

On March 5, Reps. Ed Perlmutter (D-Colo.) and Frank Lucas (R-Okla.) introduced a bill in the House ([H.R. 1349](#)) that would create a new Federal Accounting Oversight Board (FAOB) to approve and oversee accounting principles and standards for the Office of Thrift Supervision, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration, the Securities and Exchange Commission

(SEC), the Federal Reserve System, and the Office of the Comptroller of the Currency. The FAOB would be made up of five regulators – the Chairman of the Board of Governors of the Federal Reserve (who would chair the FAOB), the Secretary of the Treasury, and the chairmen of the SEC, the FDIC, and the Public Accounting Oversight Board – who would be charged with overseeing the application of U.S. generally accepted accounting principles (GAAP) to financial markets. Currently, only the SEC has this responsibility. The bill was referred to the House Committee on Financial Services.

Financial Product Safety Commission Act

On March 10, Sens. Richard Durbin (D-Ill.) and Charles Schumer (D-N.Y.) introduced a bill ([S. 566](#)) to create a Financial Product Safety Commission that would provide consumers with stronger protection in the area of consumer financial products. The five-person committee would be charged with minimizing unreasonable consumer risk from the purchase of financial products by preventing abusive practices or those that lead consumers to incur unreasonable debt, ensuring that lenders provide financial products only to consumers with an adequate credit history. The committee would also investigate, resolve, and inform the public about consumer complaints regarding financial products. The bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Federal Regulation

Board of Governors of the Federal Reserve

Proposed Rule to Allow Banks to Establish Excess Balance Accounts at Reserve Banks

On January 30, the Board of Governors of the Federal Reserve proposed an amendment to Regulation D ([74 Federal Register, pp. 5628-31](#)) that would allow depository institutions to directly establish excess balance accounts (EBAs) at Federal Reserve Banks. Currently, excess reserves are held in accounts managed by pass-through correspondents who are responsible for distributing the funds to depository institutions upon request. The proposed rule would change the legal designation of the accounts to establish a direct link between the Reserve Banks and depository institutions. As a result, the excess reserves would be listed on the balance sheets of the depository institutions rather than those of the correspondents. Comments were due March 2.

Federal Accounting Standards Board

Final Staff Positions on Mark-to-Market, Other Than Temporary Impairments

On April 9, the Financial Standards Accounting Board (FASB) issued three final staff positions (FSPs) – two related to mark-to-market accounting ([FAS 107-1 and APB 28-1](#), [FAS 157-4](#)), and one related to impaired debt securities ([FAS 115-2 and FAS 124-2](#)) – effective beginning in the second quarter of 2009. The first FSP (FAS 107-1 and APB 28-1) requires that public companies provide fair value disclosures for interim reporting periods for any financial instruments (such as loans in commercial banks) for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position, as required by Statement 107. The second FSP (FAS 157-4) allows companies to use valuation techniques such as management estimate of expected cash flows to price assets if they determine that the market for those assets has become inactive or is exhibiting only distressed sales. The third FSP (FAS 115-2 and FAS 124-2) requires companies to recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income and to release more timely disclosures regarding expected cash flows, credit losses, and aging securities with unrealized losses. These rules were first proposed on March 17.

Securities and Exchange Commission

SEC Approves Two CDS Clearinghouses

On March 6, the Securities and Exchange Commission (SEC) approved conditional exemptions that [allow ICE US Trust LLC](#) to operate as a clearinghouse for credit default swaps (CDS). On March 13, the same exemptions were [extended to the Chicago Mercantile Exchange Inc.](#) These approvals give the SEC regulatory oversight of the central counterparties – the clearinghouses – which will help it to increase transparency in the market and protect investors. So far, the only other group authorized to operate as a CDS clearinghouse is LCH.Clearnet Ltd, which [received approval](#) on December 24, 2008. Prior to this, CDS had been unregulated and traded over-the-counter. On March 13, an ICE subsidiary cleared the first bilateral CDS in the United States.

Judicial Rulings

Supreme Court Rulings

Federal Courts Limited in Compelling Arbitration

On March 9, the U.S. Supreme Court overturned (5-4) an appellate court's ruling compelling arbitration in federal court between Discover Bank and a cardholder over recovery of past-due charges, ruling that the federal court lacked jurisdiction to adjudicate the state-based claim ([Vaden v. Discover Bank](#), U.S., No. 07-773, 3/9/09). Section 4 of the Federal Arbitration Act authorizes a U.S. district court to compel arbitration if the court would have jurisdiction over the case, save for the arbitration agreement. The Supreme Court found that even though Vaden's state-law-based counterclaim was preempted by federal law, because no questions of federal law arose from the main dispute over the collection of the debt, the federal court had no jurisdiction to remove the case from state court and compel arbitration. The court ruled that although a federal court may "look through" a Section 4 petition, it cannot compel arbitration unless the whole controversy between the parties arises under federal law.